

Managed Dental Care
Notes to Financial Statements
December 31, 2003

File No. 933-0302

NOTE 1 - ORGANIZATION AND BUSINESS

Managed Dental Care (the “Company”) was incorporated under the laws of the State of California on June 4, 1991, for the purpose of providing prepaid dental services for employer groups and unions in selected areas throughout the State. The Company has been licensed by the Department of Corporations since December 24, 1991 and has operated as a licensed health care service plan under the Knox-Keene Act (the “Act”) since January 1, 1992. Effective in 2000, HMOs in the State of California are regulated by the Department of Managed Health Care (the “DMHC”). The DMHC is exclusively devoted to the licensing and regulation of health care service plans or HMOs. The DMHC will continue to enforce the Act and has increased authority to protect health plan subscribers and enrollees. Under the Act, the Company must comply with certain minimum capital or tangible net equity (“TNE”) requirements. The Company is required to periodically file financial statements with the DMHC in accordance with statutory accounting and reporting practices. As of December 31, 2003, the Company exceeded the minimum TNE requirement of \$203,578. Effective April 25, 1996, all of the outstanding shares of the Company were purchased by the Guardian Life Insurance Company of America (the “Parent”). This transaction did not change the historical basis of the assets of the Company.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company prepares its financial statements in accordance with the AICPA Auditing and Accounting Guide for “Health Care Organizations.” The following is a summary of significant accounting policies used in the preparation of the accompanying financial statements. Such policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of the Company’s financial statements relate to the assessment of the carrying value of receivables and capitation and claims payable. While management believes that the carrying value of such assets and liabilities are adequate as of December 31, 2003, it is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premium Revenue

Membership contracts are written on a one- or two-year basis. Premiums are due monthly and are recognized as revenue during the period in which the Company is obligated to provide dental services to its members.

Dental Service Cost Recognition

The Company contracts with various general practitioners and specialists for the provision of specified dental services to its members. The Company primarily compensates general practitioners on a capitated basis. Capitation is a fixed, monthly payment made without regard to the frequency, extent or nature of the health care services actually furnished. The Company also makes supplemental payments to its general practitioners for providing certain services to its members based on a defined fee schedule. Services performed by specialists must be approved by the Company prior to service being provided and are reimbursed based on a defined fee schedule. Provider contracts may be terminated by either party upon giving ninety days written notice.

The cost of dental services provided or contracted for is accrued in the period in which it is provided to a member based in part on estimates, including an accrual for the cost of dental services incurred but not reported to the Company.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents. At December 31, 2003, there were no cash equivalents. The Company maintains cash deposits in financial institutions, which exceed the amount insured by the U.S. Government. Nonperformance by these institutions could expose the Company to losses for amounts in excess of the insured balances. However, the Company has not experienced nor anticipates nonperformance by the institutions.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Expenditures for maintenance and repairs are charged against operations. Renewals and betterments that materially extend the life of the assets are capitalized. Depreciation and amortization is computed on a straight-line basis over the useful lives ranging from five years for computer hardware and software, seven years for furniture and fixtures, and the remaining life of the lease for leasehold improvements.

Federal Income Taxes

The Company has a tax sharing agreement with the Parent and is included in the consolidated federal return filed by the Parent. The provision for income taxes has been computed as if the Company files returns on a separate-company basis. Current federal income taxes so computed are receivable or are payable by the Company to the Parent. State and local income taxes are filed on a separate-company basis with the appropriate authorities.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax reporting purposes. The Company has established a valuation allowance for its deferred tax assets that are not likely to be realized.

NOTE 3 - MANAGEMENT PLANS

Prior to 2002, the Company had suffered recurring losses. The Parent has provided the Company a written letter of financial support of \$5 million for a term without expiration, of which \$1.5 million has been contributed to date. As of December 31, 2003, the Parent has not made any additional contributions to the Company.

The Company is undertaking a number of initiatives to enhance growth, including new products and marketing programs. The Company will continue to implement measures to increase membership, cash flow and revenues.

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NOTE 4 - CERTIFICATE OF DEPOSIT

The Company is required by the DMHC to maintain \$50,000 in a certificate of deposit in order to meet the licensing requirements for a health care service plan. These funds, classified as other non-current assets in the accompanying balance sheet, can only be used by the Company in the event of termination of the business.

NOTE 5 - INCOME TAXES

The provision for income taxes consists of the following for the year ended December 31, 2002:

Current:	
Federal expense	\$ 18,524
State expense	<u>6,003</u>
	<u>24,527</u>
Deferred:	
Federal expense	3,374
State expense	<u>1,241</u>
	<u>4,615</u>
Income tax expense	<u>\$ 29,142</u>

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NOTE 5 - INCOME TAXES (Continued)

The significant components of the liability for deferred income taxes at December 31, 2002 are as follows:

Deferred tax assets:	
State taxes	\$ 1,821
State NOL carryforward	<u>49,691</u>
Total deferred tax assets	<u>51,512</u>
Deferred tax liabilities:	
Office furniture and equipment	<u>(5,806)</u>
Total deferred tax liabilities	<u>(5,806)</u>
Valuation allowance	<u>(49,691)</u>
Net deferred tax liability	<u><u>\$ (3,985)</u></u>

At December 31, 2002, the Company had a state NOL carryforward of \$562,121 expiring in 2004 through 2013. The Company has established a valuation allowance for the full amount of the state NOL carryforward.

Income taxes computed at the statutory federal income tax rate of 35% and taxes provided differ as follows for the year ended December 31, 2002:

Income tax expense at the statutory federal rate	\$ 19,786
Permanent differences	637
State taxes, net of federal benefits	5,423
Other, net	<u>3,296</u>
Income tax expense	<u><u>\$ 29,142</u></u>

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NOTE 6 - RELATED PARTY TRANSACTIONS

At December 31, 2003, the Parent had obligations to the Company in the amount of \$9,896. This amount relates to expenditures for salaries, rent, benefits and small equipment paid by the Company on behalf of the Parent and the intercompany income tax receivable.

At December 31, 2003, the Company had obligations to the Parent in the amount of \$143,041. This amount relates to sales commissions and fees charged the Company by the Parent for dental network management services.

As a wholly owned subsidiary of the Parent, the Company receives services from the Parent including broker services and employee services for dental network management and pays for expenditures related to the Parent including insurance, rent and office supplies. Because of this relationship, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties. The Parent also pays for certain services of the Company for which it does not charge. These services include the annual financial statement audit and the salary of one individual.

NOTE 7 - COMMITMENTS

The Company is currently leasing its office space under a non-cancelable operating lease (the "Original Lease"). The Original Lease is scheduled to expire in April 2003. The Company has entered into an addendum to the Original Lease extending the lease term to April 30, 2008. Under this addendum, the Company has the right to terminate the lease on April 30, 2006, upon giving one year's written notice. Upon terminating the lease, the Company would be required to pay the landlord a termination fee representing the unamortized cost of certain tenant improvements made by the landlord on behalf of the Company as well as any excused rent. As of December 31, 2003, the landlord has not made any tenant improvements on behalf of the Company, nor has the Company been excused from any rental obligations. Rent expense for the quarter was \$33,387 and sublease income from the Parent for the year was \$17,863. Future minimum rental payments under the lease term are as follows:

<u>Year Ended</u>	<u>Amount</u>
2003	\$ 149,454
2004	204,989
2005	211,139
2006	<u>71,070</u>
	<u>\$ 636,652</u>

NOTE 8 - PROFESSIONAL LIABILITY INSURANCE

The Company's Parent elected not to renew the Company's commercial managed care professional liability insurance effective June 2002. The Company's Parent is self insuring this coverage and has approved the restriction of assets in the amount of \$500,000 in connection with this coverage. No claims have been reported to date and therefore, the Company believes an accrual is not necessary as of December 31, 2003.

NOTE 9 - RETIREMENT & BENEFIT PLAN

The Company adopted the Managed Dental Care of California Retirement and Savings Plan (the "Plan") on January 1, 1997. The Plan was amended on May 1, 1998 to include employer matching contributions. Under the Plan, employees who have completed one year of service and are at least 20 years of age are eligible to participate in the Plan. The Company may make matching contributions equal to a discretionary percentage of the employee's gross earnings from the Company. The employer's contributions vest gradually and are fully vested after five years of service with the Company. The Company made contributions of approximately \$5,160 for the quarter ended December 31, 2003.